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State of the Agency

BPA Prepares for the 21st Century

April 1998

This is an historic time for the Bonneville Power Administration and for the Pacific Northwest. Over the next year, BPA and the region face a number of issues arguably more complex than at any time in the agency's history. How these issues are resolved will define the BPA of the 21st century in the new national climate of utility deregulation.

Today, BPA is financially healthy and in excellent position to address the challenges ahead. BPA has been preparing for its future since 1993, when the first impacts of wholesale electric energy deregulation were reverberating throughout the country. Facing competition for the first time, BPA responded with the Competitiveness Project. This led to developing a business plan, reorganizing and re-engineering the agency, downsizing staff by 20 percent, cutting costs by hundreds of millions of dollars, lowering power rates by 13 percent, functionally separating the power and transmission business lines to ensure open, nondiscriminatory access to our transmission system and rebuilding our cash reserves.

**BPA has been
preparing for the
21st century
since the early
1990s.**

Mindful also of our obligations to U.S. taxpayers, in 1996 BPA refinanced its low-cost appropriated debt with the U.S. Treasury at 7.1 percent, which was the current rate at the time. This new rate is now 1.5 percent higher than current Treasury financing, making this a very good deal for taxpayers. BPA provided an additional \$100 million to the Congress and U.S. taxpayer as a result of the bipartisan refinancing agreement. In all, through 1997, BPA has returned approximately \$11.5 billion to the U.S. Treasury in principal and interest.

All of these actions – from cost cutting to debt refinancing – stabilized BPA at a time when the wholesale electricity industry was changing almost overnight. They bought time for the region to define – through the Northwest governors' Comprehensive Review of the Northwest Energy System – what it

wanted the BPA of the future to be. This State of the Agency report addresses how we are implementing the recommendations of the Comprehensive Review.

BPA ended its most recent fiscal year with \$430 million in cash reserves, more than twice the reserves it had in 1995. We continue to trim costs, and we have achieved our lowest staffing levels since 1965. Most important, customers who just months before were wondering if BPA power would be competitive are now lining up for that power.

The actions we and the region will take in the coming weeks and months will be critical to maintaining this momentum. A great deal is at stake, namely ensuring the region gets the greatest value out of the federal Columbia River system. The road ahead is not without its challenges. In the wake of El Nino, California got our rain, and we got some of that state's traditional dryness. This year's streamflows are about 87 percent of normal, not the best news for our hydro-based system.



Despite the onset of competition, BPA has built up its financial reserves, more than doubling the amount since 1995.

While BPA is fundamentally sound thanks to the steps it has taken, we cannot afford to rest on our laurels. Contracts for about three-quarters of our power expire in 2001. An agreement to keep fish and wildlife costs stable that made the existing contracts attractive to customers also expires at that time. We are feeling a sense of urgency to sell power to our Northwest customers for the period after 2001. This market is moving, and BPA needs to move with it.



Today, BPA's staffing level is the lowest since 1965.

Although it will be three years before our existing contracts expire, it is important that we begin offering replacement contracts as soon as possible for three very important reasons.

First, many of our Northwest customers already are talking to power marketers hoping to line up their power supplies for 2001 and beyond. If we wait much longer, we will lose market share as some of these customers will go elsewhere. And one maxim that is almost universally accepted in the marketplace is that it is easier to keep a customer than attract a new one.

Second, today's electricity market is a commodity market, which means it is increasingly volatile and unpredictable. Compared to last year, electricity prices are up. But there is no crystal ball about next year's prices. It makes sense to begin contracting now when prices are attractive for BPA. This will lessen the risk that BPA will need to sell when prices cycle down.

Customers who just months before were wondering if BPA power would be competitive are now lining up for that power. Early pre-subscription sales will bring in an average of \$136 million a year between 2002 and 2006.

Third, if BPA waits until the point when contracts are expiring, we may find ourselves actually creating an artificially low market by having to sell too much power in too short a time.

The key issues

There are a number of issues ahead, but the big three that need most immediate attention include:

1. Fish and wildlife funding

BPA has twin challenges here. On the one hand, we have an obligation to the region's fish and wildlife resources that we are committed to carrying out in the most responsible way. BPA invests hundreds of millions of dollars in fish and wildlife each year. In addition, BPA also has made \$325 million in payments since the early 1980s to cover fish and wildlife obligations that were not related to hydropower production. This money has been put in a contingency fund that can be drawn on under certain stringent conditions. Thus far, BPA has not sought money from the fund.

No one wants the regional fish and wildlife efforts to succeed more than BPA. BPA is working with the region to identify a reasonable range of fish and wildlife options open and giving customers cost predictability.

No one wants the regional fish and wildlife efforts to succeed more than BPA. At the same time, we know that our customers will not sign contracts if they perceive they are signing blank checks. Since our rates are cost based, customers want reasonable predictability in costs, or they will take their business elsewhere.

BPA is currently working with the region toward two funding objectives for fish and wildlife: 1) identifying a reasonable range of costs for BPA's obligation in the 2002-2006 period; and 2) developing contingent funding mechanisms in the event the higher end of this range materializes.

Our goals are to keep realistic options open for fish and wildlife, while giving customers cost predictability.

2. **Cost structure of the federal system**

To ensure we thrive in today's intensely competitive electricity market, we must get our costs as low as possible consistent with sound business practices. Since 1994, we have made huge strides in reducing costs, cutting \$600 million a year from what we had previously budgeted through 2001, and reducing our power prices by 13 percent and guaranteeing the rate for five years. Still, we know we can do more.

To ensure that we do not miss any opportunity for cost cutting, we cosponsored with the Northwest Power Planning Council a "Cost Review" panel of business experts. These experts recommended cost management improvements beyond those BPA already has achieved. We are now considering how to implement these recommendations, but not all the savings can be made by BPA alone. For example, the largest savings recommendation – \$48 million – calls for better coordination among the three river managers: BPA, the U.S. Army Corps of Engineers and the Bureau of Reclamation. Some recommendations would require legislation.

3. **Subscription**

Subscription means selling BPA's power as recommended by the Comprehensive Review. A successful subscription process is the most crucial element in BPA's future stability and in ensuring we meet our Treasury payments. It will produce the revenues that enable us to pay our creditors and meet our obligations. We are seeking to open the subscription door in July. BPA will lose sales to existing customers if it stays out of the market.

A successful subscription process is crucial to BPA's future. It will produce the revenues that enable BPA to pay its creditors and meet its public responsibilities.

There are healthy signs from customers that BPA's federal power is a highly desirable product. As of mid April, BPA had signed pre-subscription contracts to sell 850 average megawatts that will bring in annual revenues of approximately \$125 million each year from 2002 through 2006. Other customers are already in line.

This will be the first time that BPA sells into a fiercely competitive environment where customers are free to choose other suppliers. We must make sure that our products and services meet our customers' needs, and we must market our product more effectively than other power suppliers. Although subscription is scheduled to start in July, we anticipate it will be spread over two years, involving hundreds of individual transactions designed to meet individual customers' needs and timetables.



For the past 14 years, BPA has paid its U.S. Treasury payment on time and in full, for a total of \$11.5 billion in principal and interest.

Legislative issues

The governor's Transition Board, which was set up to help implement the Comprehensive Review recommendations, is developing recommendations to Congress for legislation. Such legislation will be important to how BPA and the federal hydropower system will operate in the nation's deregulated and transformed electricity industry. Three major areas that may require legislation include the following.

A great deal is at stake, namely ensuring the region gets the greatest value out of the federal Columbia River system.

Emergency cost recovery

As long as it is clear the U.S. taxpayer investment in the Columbia River hydro system is being repaid on schedule, the Northwest has a compelling argument for retaining the benefits of this system. The region needs a revenue-collection mechanism to address the risks of under-recovery of BPA power costs should unpredictable events occur, such as unexpectedly low market prices or higher than planned costs. Such a mechanism should protect the U.S. taxpayer – BPA's major creditor – from potential risk by assuring that the region that benefits from BPA's power will cover the costs of that power in all future scenarios.

Transmission access and operation

Open access to transmission lines is key to creating a competitive electricity market which can lead to lower costs for all consumers. The Federal Energy Regulatory Commission has issued regulations that require transmission owners to provide open access to their transmission service. This assures that owners of transmission do not deny access merely to increase revenues from the electricity generation side of their own business.

Although BPA is not subject to the Federal Energy Regulatory Commission's open access rulemakings, we are complying with these rules and support their objective of creating and sustaining competitive wholesale power markets. BPA has functionally separated its power and transmission into two distinct businesses. During the past year, we completed relocation of people and equipment, consolidating power operations in Portland, Ore., and transmission operations across the Columbia River in Vancouver, Wash.

Currently, the region is exploring the possibility of Federal Power Act compliance for BPA that would provide increased Federal Energy Regulatory Commission regulation for BPA's transmission system. Such regulation could be similar to the commission's oversight of investor-owned utility transmission systems, although it likely would have to take into account BPA's unique system.

Cost reduction measures

In addition, BPA may need greater administrative flexibility if it is to successfully manage its costs. Citing the demands of the competitive market, the Cost Review panel recommended that region pursue legislation to improve BPA's effectiveness and efficiency in procurement and personnel management.

Building toward a regional consensus

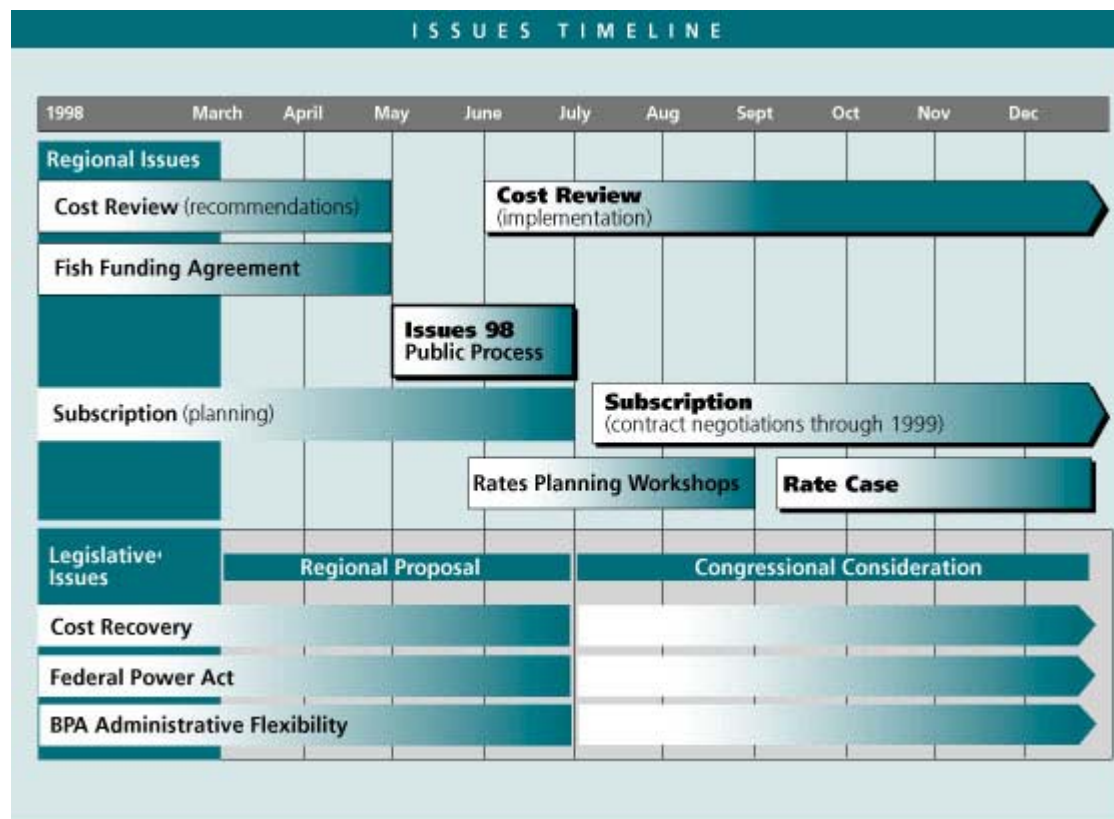
The processes described below are explicitly designed to implement the recommendations of the Northwest governors' Comprehensive Review. The schedules for these issues and processes are displayed in the timeline below.

Currently, we are developing a set of draft planning assumptions based on progress that has already been made in separate regional discussions of the issues. Because the ongoing discussions – some conducted by BPA and some by other parties – have focused primarily on individual issues, the region has yet to see planning assumptions all in one place. Issues '98 will provide that opportunity.

Issues '98

On May 19, BPA will release draft planning assumptions for the assortment of individual issues that have been on separate paths. This will enable the region to evaluate on a single screen how the region's fundamental objectives for the federal hydropower system will be met in the 21st century. Those objectives are to secure the benefits of the system for the region's consumers and for the environment of the Northwest. Examples of planning assumptions are how much power is expected to be available from the federal power system, what the potential range of fish and wildlife costs might be, what savings may

accrue from the Cost Review recommendations and what amount of revenues BPA will need to cover its costs in the 2002-2006 period. Comment will be sought through June 19 in meetings ranging from small workshops with parties of like interest to large regional public meetings. Issues '98 will give the region an opportunity to see "the big picture" and the context for individual issues. Issues '98 also will be the final opportunity for public comment on the Cost Review recommendations, since the Cost Review panel itself already has conducted an extensive regional comment period earlier this year. In addition, in recognition of their sovereign status, we will be conducting separate consultations with Northwest tribes on these issues.



A number of major issues are coming together, and BPA is planning several opportunities for the region to participate. This graph shows general schedules for individual processes addressing the key issues.

The 1998 power rate case

Issues '98 is not a decision-making process, but an opportunity for the region to understand and influence the assumptions that will inform BPA's upcoming subscription process and rate case to be conducted later this year. This ratemaking, which also is a public process, will set prices for BPA's core power subscription products from 2002 to 2006. Transmission rate design and most other issues associated with transmission services for the post-2001 period will be addressed in a ratemaking that will come after the power rate case. But it is realistic to expect some issues important to transmission customers will come up in the Issues '98 discussion and in rate case workshops to be conducted this summer.

In closing

Today, BPA is sound and, as a result, in a very good position to deal with the large, complex and varied issues described in this report. But we need to move expeditiously on these issues to secure the highest value of the Columbia River system for Northwest consumers and the region's environment. Together we can shape a bright economic and environmental future for the Northwest.

For more information

If you would like more information about the Bonneville Power Administration, visit our Web site at: <http://www.bpa.gov>, or call us in Portland, Ore., at (503) 230-7334, or outside the Portland area at (800) 622-4520.

This *keeping Current* was created by BPA Corporate Communications.

It was posted on the Internet by Katie Leonard, keleonard@bpa.gov.

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